***United States Court of Appeals***

***for the Second Circuit***


# APPELLANT'S BRIEF

ORIGINAL

75-5025-6

IN THE

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

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DOCKET NO. 75-5025-6

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In re

CONTINENTAL VENDING MACHINE CORP. and
CONTINENTAL APCO, INC.,

Debtors.

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JAMES TALCOTT, INC.,

Appellant,

IRVING L. WHARTON, TRUSTEE,

Appellee.

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ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE EASTERN
DISTRICT OF NEW YORK

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# APPELLANT'S BRIEF

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## INTRODUCTION

The appeal is from two orders of the United States District Court for the Eastern District of New York, Mishler, Ch.J., one entered November 18, 1975, the other December 15, 1975 on rehearing, and from the first as affected by the second.

The appeal is another phase of a continuing controversy in a Chapter X bankruptcy reorganization between James Talcott, Inc. (Talcott), a secured creditor, and the reorganization trustee. There were two previous appeals. The first involved the proper application, on Talcott's accounting, of proceeds of a part of its security; it resulted in a remand. 491 F. 2d 813 (1974). The second involved Talcott's objection to confirmation of the trustee's plan of reorganization in so far as it affected application of proceeds of another part of Talcott's security; in a split decision it resulted in confirmation of the plan. 517 F. 2d 997, rehearing and rehearing en banc denied September 15, 1975, certiorari denied February 23, 1976.

The two appeals bear upon the subject matter of the instant appeal and the opinions furnish relevant background. Overall background for the reorganization proceeding including Talcott's participation appears in the trustee's report of June 23, 1969, pursuant to §167(5), Bankruptcy Act (Claimant's Exh. PPP).

## QUESTIONS PRESENTED

1. Whether §243 of the Bankruptcy Act or a provision in a security agreement controls compensability of legal services and other expenses incurred by the secured creditor claiming reimbursement out of the security.

2. Whether in this case the special master's determination on the secured creditor's claim for reimbursement of attorney's fees and other expenses, pursuant to a security agreement, is clearly erroneous, an abuse of discretion or otherwise improper so as to warrant modification of his report by the district court.

3. Whether pursuant to 28 U.S.C. §455 it is mandatory for a judge to disqualify himself from passing on a special master's report where the judge had been a witness for a party before him in a trial of an issue involved in the report, the issue having been referred upon the judge's recusal.

## STATEMENT OF CASE

### I - The Debtors and reorganization proceedings

Continental Vending Machine Corp. (Continental) is a publicly owned Indiana corporation. It designed and manufactured coin-activated vending machines dispensing cigarettes, beverages,

food and music. The machines were installed and operated on vending routes throughout the United States. Each route consisted of a cluster of locations on which machines were placed pursuant to contracts with location owners such as theatres, stores, offices and industrial plants. Each route was in a particular geographical area, hence identified as the San Francisco route, Buffalo route. Continental's property interests in the routes were the vending machines, location contracts and inventories of the items dispensed by the machines.

Continental Apco, Inc. (Apco) is a New York corporation wholly owned by Continental. Acting as Continental's sales arm, Apco sold the machines to Continental's subsidiaries, since defunct, and to the general trade.

Mismanagement, derelictions and other questionable activities seriously affected Continental's financial condition in the spring of 1963. Investigations by Internal Revenue Service and by Amex resulted in suspension of trading in Continental's securities. Investigation by Securities and Exchange Commission followed.

On application of Securities and Exchange Commission, April 8, 1963, an order was entered in the United States District Court, Southern District of New York, appointing John P. Campbell

conservator for Continental. He continued operations of both Continental and Apco although Apco was not brought into the proceeding.

July 5, 1963, an involuntary petition in bankruptcy was filed against Continental in the Eastern District of New York. This petition for bankruptcy adjudication was superseded July 10, 1963 by filing in the Eastern District of New York of an involuntary petition against Continental for reorganization under Chapter X of the Bankruptcy Act. The petition was approved by order of July 12, 1963, which appointed John P. Campbell, the conservator, and Irving L. Wharton trustees. They continued operations of both Continental and Apco although Apco was not brought into the reorganization proceeding.

October 4, 1963 an involuntary Chapter X petition for reorganization was filed against Apco. The petition was approved by order of October 10, 1963 and Continental's trustees were appointed trustees for Apco.

September 14, 1964, John P. Campbell resigned and Irving L. Wharton continued as sole trustee for both debtors.

By July, 1974, all assets of both debtors had been liquidated, no business remained to operate or reorganize.

June 15, 1970, the trustee filed an amended plan of "reorganization" (liquidation) which consolidated the assets and liabilities of the two debtors. The plan was confirmed by order, August 12, 1974, affirmed June 5, 1975, 517 F. 2d 997, supra.

Proceeds of sale of Continental's manufacturing operation, which was only partly encumbered by liens, recoveries from trustee's actions and interest on the investment of the trustee's funds resulted in some $5,000,000 net (112a) for distribution to general creditors and administration expenses. The debts are in excess of $10,000,000 (1331).

II - Talcott's secured financing

Talcott was the principal financer of the operations of Continental and Apco. All of its loans and advances were secured. As security for Continental's obligations Talcott received chattel mortgages covering vending machines on locations, assignments of location contracts, liens on machines in warehouses and other places off the routes. As security for Apco's obligations Talcott received assignments of accounts receivable and notes arising from sales of machines, assignments of conditional sale contracts and liens on machines returned by customers.

All obligations of both debtors were covered by master security agreements each containing a broad provision commonly referred to as cross-collateralization or dragnet clause or a general lien clause. It provided that any and all security held by Talcott for a specific obligation arising under the agreement stood as security also for any and all other obligations of the borrower, whether arising under the particular agreement or under any other agreement and whether then existing or thereafter created. Thus whatever property of Continental came within the orbit of Talcott's security interest stood as security for any and all obligations of Continental. And this was also true with respect to Apco's property held as security by Talcott. As a consequence there were no unsecured debts to Talcott, all debts were secured under the agreements.

At the time of appointment of the conservator, Continental's obligations to Talcott were about $3,500,000 and Apco's obligations approximated $2,000,000.

Upon commencement of the conservatorship for Continental and successive reorganization proceedings of Continental and Apco, Talcott began and thereafter continued liquidation of its security to obtain payment of the debts due. It collected assigned accounts receivable and notes, repossessed machines subject to

defaulted chattel mortgages and conditional sales contracts, sold these machines and machines in warehouses and arranged with the debtors to recondition, repair and sell machines returned by purchasers.

Liquidation of security produced a $380,000 surplus in the Apco account and $820,000 deficiency in the Continental account. The right to offset the surplus against the deficiency was the subject matter of the second appeal. 517 F. 2d 997, supra.

While liquidating its security and in connection with it, Talcott made urgently needed loans to the conservator: $300,000 on April 22, 1963; $175,000 on May 29, 1963. These were secured by conservator's certificates. On June 28, 1963, Talcott loaned Apco $200,000, later secured by trustees' certificates. Talcott made two additional urgently needed loans secured by trustees' certificates: $650,000, nominally to Apco, on August 14, 1963 and $750,000 to the trustees on December 4, 1963. On these loans exceeding $2,000,000 and secured by certificates, there remained, as of December 31, 1971, an unpaid balance of $875,487.22 inclusive of interest. With accrued interest to date, the balance is over $1,000,000.

III - Talcott's accounting and proof of claim

In September 1972, Talcott moved for an order directing the trustee to pay the $875,487.22 balance due on the certificates as of December 31, 1971. The trustee opposed and counter-moved for an order directing Talcott to file an accounting of all moneys received on its security. One of the issues was whether without court approval Talcott, pursuant to its financing agreements, could reimburse itself out of security proceeds for attorneys fees and other expenses incurred in security liquidation.

By order of February 13, 1973 the court denied Talcott's motion and directed the accounting, holding the reimbursement improper. Talcott filed an accounting including a separate March 14, 1973 affidavit of J. Jacob Hahn, senior partner of Talcott's attorneys firm, in support of claim for reimbursement for attorney's fees.

In the meantime, Talcott took an appeal from the February 13, 1973 order. This court agreed that court approval was necessary for reimbursement and for such approval it held a §196 proof of claim should be filed. 491 F. 2d 813, 821-822. Implementing this court's decision, the district court, by order of July 10, 1974, directed filing a proof of claim. The proof of claim was filed on April 30, 1974. (Document 8, 226-398) Finding

it insufficient the court, on May 22, 1974, referred it to Magistrate Vincent A. Catoggio as special master.

In aid of understanding this bulky document a description is believed to be appropriate. The claim itself is an affidavit of George Fairberg, Talcott's vice-president, (228-232) claiming a total of $375,740.04 (229) which includes:

| | |
|---|---|
| (a) Legal charges from March 30, 1963 through December 31, 1967. | $207,490.58 |
| (b) Legal charges from January 1, 1968 through March 19, 1973. | 60,000.00 |
| (c) Auditing, collection and miscellaneous charges from November 14, 1963 through December 31, 1971. | 101,705.38 |
| (d) Additional charges, not yet subject of accounting, from January 1, 1972 through March 8, 1974. | 6,544.08 |
| Total | $375,740.04 |

Annexed to Fairberg's affidavit are seven exhibits, five of which are in support of the above charges:

A - Affidavit of Mark Rosenbaum, Talcott's assistant vice president (233-234) with annexed Schedule "A" listing 26 payments of legal fees and disbursements totaling $207,490.58 which is charge (a) in Fairberg's affidavit. The listing includes a total of $205,000 fees and $704.50 disbursements paid to Talcott's attorneys and $1,786.08 to other attorneys.

B - Affidavit of J. Jacob Hahn, senior partner in the firm of Talcott's attorneys (238-323) reciting legal services and

annexing paid bills therefor [Exhibits A-1 through A-5 (324-343)] amounting to $205,000 itemized in Schedule "A" to the above Rosenbaum affidavit.

C - Supplemental affidavit of J. Jacob Hahn (344-360) reciting legal services after December 31, 1967, which had not been completed and could not be valued (344-345). Annexed is a paid bill for $60,000 "On Account" (361) which is charge (b) in Fairberg's affidavit.

D - Affidavit of George Fairberg (362-363) in support of $101,705,38 for auditing, collection and miscellaneous charges [charge (c) in his claim affidavit]. Annexed are Schedule "A" (364-385) of 219 items and Schedule "B" (386-387) identifying the auditors and collectors and showing hours spent by each.

E - Schedule of seven legal disbursements totaling $6,544.08 (388) which is charge (d) in Fairberg's claim affidavit.

Fairberg's claim affidavit states (231) that on December 29, 1964, Talcott filed two secured claims as of November 30, 1964, each "with interest and charges accruing thereon thereafter until paid". He adds that the present proof of claim "supplements the said two claims to the extent of the accrued charges". The two claims are affidavits of James J. Coy, Talcott's former vice president: F (389-393) and G (394-398).

The master held thirteen hearing sessions. On the charges for legal services practically all the testimony was Hahn's. It was supplemented by the affidavits of Frank J. Ryan, a partner, (Claimant's Exh. 4Z), Lawrence G. Novick, a partner, (Claimant's Exh. 3C and NN) and Julius J. Abeson, senior associate, (Claimant's Exh. 5A) who also testified. The trustee waived testimony of Ryan and Novick. On the other charges there was testimony from Fairberg and Rosenbaum, whose affidavits are part of the proof of claim, and from Fred Goldberger, former head of Talcott's auditing department. Their testimony was supplemented by the affidavit of Joseph Brady, Talcott's former employee who did collection work. (Claimant's Exh. 5L) The trustee waived Brady's testimony.

All of Talcott's witnesses were cross-examined by trustee's counsel. No witnesses were produced by the trustee and Talcott's evidence is undisputed. The record before the master comprised 1,655 transcript pages and 240 exhibits.

April 28, 1975, the master filed his report (125a-156a). Of the 4,296 hours claimed in rendition of the services by Hahn's firm (132a) he allowed 3,662 (149a). Applying hourly rates used by the court in a related proceeding, the master allowed $127,250 for the legal services (149a). Applying other well established standards - results accomplished, quality and complexity of the services, expertise and standing of the attorneys - the master

added $22,750 and thus found $150,000 to be the reasonable value of the legal services. (151a)

The master also allowed $3,231.59 of legal disbursements, not passing on $6,544.08 additional disbursements at Talcott's suggestion. (155a-156a) Talcott reduced its claim for auditing, collection and miscellaneous charges from $101,705.38 to $95,645.38 (152a) and the master allowed the reduced amount. (155a)

The trustee filed objections to the master's report. (Document 25) Talcott moved to confirm the report. (Document 26) By decision and order of November 18, 1975 (161a-191a) the court modified the master's findings as to the legal services by disallowing some items of services, allowing the hours allowed for other services and disallowing the master's "premium" above the amount based on hourly rates. The court also disallowed some disbursements and reduced the master's finding as to the auditing, collection and miscellaneous charges. (192a-194a) The modifications resulted in an allowance of $28,735 for legal services and $90,373.84 for disbursements and the other charges. (191a)

The trustee moved for rehearing (Documents 28 and 29) mainly regarding certain disbursements. Talcott cross-moved for rehearing on the ground that pursuant to 28 U.S.C. §455, the

judge should have disqualified himself from passing on the master's report because he had been a witness for the trustee before Judge Judd. (195a-201a) The rehearing motions were determined by order of December 15, 1975. (202a-209a) On the trustee's rehearing, the court disallowed the $6,544.08 disbursements which the master did not pass on at Talcott's suggestion. Five items of previously allowed disbursements totaling $5,341.01 were now disallowed. On Talcott's rehearing, the court denied the disqualification claim.

## POINT I

### SECURITY AGREEMENT, NOT §243 OF THE BANKRUPTCY ACT, CONTROLS COMPENSABILITY OF LEGAL SERVICES AND OTHER EXPENSES INCURRED BY A SECURED CREDITOR, IN A CHAPTER X PROCEEDING, CLAIMING REIMBURSEMENT OUT OF THE SECURITY

Several items of legal services and other expenses for which Talcott claims reimbursement have been disallowed below on the ground they are not compensable under §243. That section authorizes allowances out of the estate to creditors' attorneys only if the services or expenses are in connection with a plan or with objection to confirmation of a plan or in connection with administration of the estate, which in application generally includes benefit to the estate. Those Talcott claims were disallowed

because they were not for services in connection with a plan or in connection with administration.

No case has been found applying §243 to a secured creditor's claim grounded in his security agreement. In two cases cited by the court the applications for allowance were by attorneys for bondholders' committees. Delafield, Marsh & Hope v. Silberger, 228 F. 2d 838 (2 Cir. 1956); In re Chicago and West Towns Rys., 230 F. 2d 364 (7 Cir. 1956), cert. denied 351 U.S. 943. Such allowances are authorized by §242 and they are conditioned on §243 standards. Talcott's claim is authorized by contract.

The other three cases do involve compensation for services pursuant to contract but far from supporting the court's premise, they negate it. In re Intaco Puerto Rico, Inc., 357 F. Supp. 1122 (D.P.R. 1973), the court considered a clause in a mortgage for attorney's fees of 10% of the principal debt. Local law determines validity of such clauses. Security Mortgage v. Powers, 278 U.S. 149 (1928). In Puerto Rico such clauses are regarded as a penalty. Nevertheless the clause is enforced in bankruptcy by treating the stipulated fee "as a maximum limit of the reasonable fee which is to be determined by the bankruptcy court". The Intaco decision, then, looks to the contract for

the nature of the services to be compensated and leaves to the bankruptcy court to determine reasonable value.

> "Our task, therefore, is limited to interpreting the mortgage contract at hand to see whether the action taken by the secured creditor' attorney is the action contemplated in the contract as justifying payment of fees. The mere fact that a party is obliged to go into a federal court of equity to enforce an essentially local right arising upon a contract valid and unassailable under controlling state law, does not authorize the court to modify or ignore the terms of the legal obligation upon the claim or because the court thinks that these terms are harsh or oppressive or unreasonable. (Manufacturers Co. v. McKey, 294 U.S. 442, 55 S. Ct. 444 (1934)."

There is no suggestion whatever in Intaco that §243, and not the contract, controls the scope of compensable services and the lien therefor for payment.

In re General Stores Corp., 278 F. 2d 437 (2 Cir. 1960), the ruling is:

> "The scope of the lien is not a factor in the determination of the reasonable value of the services claimedto be rendered. The collateral agreement creates the right; the court determines the reasonable value."

Ruskin v. Griffith, 269 F. 2d 827 (2 Cir. 1960) is in accord and both cases are in entire agreement with Intaco.

The order of reference instructs the master to take "into account the professional standing of the lawyer" and "consider all relevant factors, such as the novelty or complexity

of the factual or legal issues, the importance of the services to the estate, and the benefit derived by the estate from those services." Conspicuously absent is any reference to §243 or any mention of contribution to a plan or objection to a plan.

A secured creditor's attorney does not represent the debtor or the trustee. His services are intended to be and are designed to benefit the creditor not the estate. His services are compensable under the security agreement even where they are "adverse to the interests of the bankrupt estate and the other creditors." In re Neil Properties, Inc., 360 F. Supp. 914 (D. Cal. C.D. 1966).

Although not a condition to an allowance, where services of a secured creditor's attorney do benefit the estate, the circumstance is given due weight in fixing the fee. Sampsell v. Monell, 162 F. 2d 4 (9 Cir. 1947). Mention in the reference order of benefit and importance to the estate was taken in that sense. The court rejected the master's pertinent findings and conclusions both for applying standards in the reference order and for not applying standards not in that order.

## POINT II

## THE MASTER'S FINDINGS ARE NOT CLEARLY ERRONEOUS, HIS CONCLUSIONS ARE NOT CONTRARY TO LAW OR AN ABUSE OF DISCRETION. MODIFICATION OF HIS REPORT BY THE DISTRICT COURT IS ERRONEOUS IN LAW.

Rule 53(b), F.R.C.P. admonishes that a reference "shall be an exception and not the rule" and "save in matters of account and of difficult computation of damages, a reference shall be made only upon a showing that some exceptional condition requires it." The reference here was not one of account or computation of damages and there is no showing in the order or elsewhere of the requisite "exceptional" condition.

Although the claim is per se not a conventional application for allowance, the court apparently viewed it as such. If so, all the more reason for not referring it. Allowances in reorganization proceedings are not proper subjects of reference even upon death of the reorganization judge. All judges are experts. Newman & Bisco v. Realty Associates Securities Corp., 173 F. 2d 609 (2 Cir. 1949). And the usual reasons given for reference - congestion of calendar, complexity of issues, great length of time required for trial - are not the "exceptional condition(s)" within Rule 53(b), F.R.C.P. La Buy v. Howes Leather Co., 325 U.S. 249 (1957) rehearing denied 352 U.S. 1019.

In the interests of movement toward resolution of its claims, Talcott did not object.

Having made the reference the court's action in respect of the report became circumscribed. It was bound by Rule 53e(2), F.R.C.P. providing: "the court shall accept the master's findings of fact unless clearly erroneous."

The modifications of the report related in some part to reduction of hours claimed on the legal services. Admittedly the hours claimed were estimates based on uncontradicted testimony and upon court and office papers and files. The court stresses absence of time records (161a) and notes that in Borgenicht, 270 F. 2d 283 (2 Cir. 1972) Hahn's firm was "cited" for failure to keep records (162a). In that case there was a remand for reconstruction of time. The reconstruction there was the same as here and Bankruptcy Judge Babitt adhered to his original allowance in view of the results accomplished.

The services here were rendered mostly in 1963 and early 1964 and Hahn's firm was then by no means alone in not keeping time records. A time record system had been installed in July 1971 and for the more recent services time slips were produced. (Claimant's Exh. 3T, 3X)

An experienced and conscientious lawyer and judicial officer, the master, applying much care and common sense, found the evidence sufficient to support by far the greater part of the hours claimed. Nevertheless he reduced the senior partners time by 195 hours and that of an associate by 699 hours. The findings as to time are of course findings of fact. That they are based on estimates and approximations is immaterial. In re Nazareth Fair Grounds & Farmers Market, Inc., 374 F. 2d 595, 597 (2 Cir. 1967); In re Webb & Knapp, 363 F. Supp. 423, 426 (S.D.N.Y. 1968). In Nazareth, this court ruled:

> "We have no doubt that the net result presents a substantially correct summary of the petitioner's activities and that the estimates of time spent is an approximation sufficiently accurate to allow the district court to pass on his application."

On one item of services where 70 hours of senior partner's time was claimed, the master reduced it to 35 hours; the court further reduced it to 10 hours. On a number of other items where the master allowed the full time claimed, the court reduced senior partner's time by 190 hours and an associate's by 150 hours. The master's findings in these circumstances were not clearly erroneous and if the court was going to substitute his judgment for the master's he should not have referred the matter in the first place.

Time spent is concededly an element considered but it is not the only one and not even the most important one. In re Borgenicht, 470 F. 2d 283 (2 Cir. 1972). Attorney's fees are not "gauged by time-clock methods * * * or on the basis of so much per day." In re Mortgage Guarantee, 40 F. Supp. 226, 230, 236 (D. Md. 1941). Time spent is only the beginning of a process of balancing it against other standards to arrive at fair and reasonable value of services in the exercise of sound judicial discretion. Here the court in an exercise of mere arithmetic considered only time spent and no other standard. The error is compounded by ignoring the other standards set forth in the order of reference which the master honored and applied.

The court disallowed some items of services held to be not compensable either under §243 or under the provision in the agreements or both. There is confusion and inconsistency in these holdings for if only the two §243 standards are applicable the agreement would seem to be irrelevant.

For its claim to reimbursement Talcott has consistently relied on the provision in the financing agreements, which appears in various parts of the record. (Proof of claim, Document 8, 230, 242; decision and order, November 18, 1975, 159a; master's report, 133a). Talcott has contended that the provision is of the broadest scope, that it "covers collection of indebtedness in

every possible way, without limitation, by legal action or without legal action. It includes every necessary or proper step 'to obtain or enforce payment'. Implicit in the language is protection and preservation of the collateral and certainly its liquidation". The court has not shown why this is not a correct interpretation of the provision. (159a)

Considering the individual or groups of services, the court identified them by the numbered paragraphs in Hahn's affidavit (Exhibit B to proof of claim, 9-10 supra). In the following discussion, the services are identified by item numbers in Hahn's affidavit and referred to appendix pages of the master report, appendix pages of the court's decision and record pages of transcript of Hahn's testimony. Services fully allowed by the court as claimed or as allowed by the master are omitted.

ITEM I - SEC INVESTIGATION AND CONSERVATORSHIP PROCEEDING (Master 138a; Judge 164a-165a; Tr. 408-580)

These services come squarely within Brown v. Security National Bank of Greensboro, 200 F. 2d 405 (4 Cir. 1952) where, as here, reorganization trustees took possession and operated the debtor's business with property subject to liens, Secured creditor's attorneys participated in the proceedings and obtained payments without foreclosure. They were awarded compensation under a clause which, somewhat as here, covered collection of the

debt by judicial proceeding and "take such steps as may be necessary or proper for the enforcement of said indebtedness against the security given." The attorneys' intervention and participation in the proceeding was held to be within the clause:

> "* * * the attorneys gave attention to the operation of the plant by the trustees, attended numerous hearings relating thereto. * *
>
> * * * Upon approval of the petition, it certainly was the duty of the (indenture) trustee to intervene in the reorganization proceedings and see the proper steps were taken therein to collect the amount due under the bonds and to protect the security covered by the deed of trust, which had been taken into possession and was being operated by the trustees * * *." p.407 of 200 F. 2d.

Brown is not distinguishable, as the court below held, (160a, note 5) and contrary to the court's view (164a) eliminating an injunction against a secured creditor's possible action is compensable, even under much narrower provisions for "costs of collection." John Hancock Mutual Life Insurance Co. v. Casey, 155 F. 2d 229 (1 Cir. 1946). This entire item of services was held not compensable under §243, which is the wrong standard.

ITEM II - PROCEEDING RE NEW YORK AND NEW JERSEY ROUTES
(Master 138a; Judge 165a-167a; Tr. 719-770)

The master allowed 160 hours for which he finds support in the testimony. The court reduced the time to 115 hours

because no time records were kept. This is true with respect to all services; the master's finding is not shown to be clearly erroneous.

ITEM III - $650,000 LOAN PURSUANT TO COURT-APPROVED AGREEMENT OF AUGUST 14, 1963 (Master 139a; Judge 167a-168a; Tr. 7190770)

The loan preserved the debtors' business and with it Talcott's security. It was instrumental in selling the routes which the trustees could not and would not do without the loan. Sale of the routes was the only way to obtain payment of the debts. The master's finding that the services were to enforce payment is not shown to be clearly erroneous. The conceded benefit to the estate is a standard in the order of reference. That the debtor was represented by counsel is irrelevant. Disallowance of these services is error in law and in fact.

ITEM IV - SALE OF ROUTES PURSUANT TO AGREEMENT OF AUGUST 14, 1963 (Master 139a-140a; Judge 168a-170a; Tr. 771-803)

These services are a continuation of Item III. Disallowance is erroneous for the same reasons. Finding or creating a purchaser for liened property and attending to its sale is part and parcel of liquidation of security, the only source of collection of debt. This is especially so in the particular cir-

cumstances of this case. The trustees imposed the condition that Talcott produce a purchaser, else the routes would not be sold. The fact that the trustee, not the creditor, sells the security does not deprive the creditor attorneys' fees reimbursement. In re Kashmir Refining Co., 94 F. 2d 652 (2 Cir. 1938). Characterization of benefit to the estate as indirect is not a valid reason for disallowance as is the fact that the services are for the creditor. Disallowance for the latter reason would destroy security agreements providing reimbursement for attorneys' fees.

ITEM V - $750,000 LOAN PURSUANT TO COURT-APPROVED AGREEMENT OF NOVEMBER 20, 1963 (Master 141a; Judge 172a-174a; Tr. 868-979)

The court does not purport to reject the master's finding that "but for this loan the debtors would have collapsed entirely and the security held by Talcott would have depreciated markedly." (174a) The reasons for disallowance are the same and as invalid as the reasons for disallowance of services in connection with the $650,000 loan (Item III). Obtaining restatement of collateral and a general release add to compensability. The loan was made to obtain both in order to put an end, once and for all, to threats of suits and recognition of the validity of Talcott's liens, the only source of obtaining payment.

ITEM IX - PREPARING AND FILING PROOFS OF CLAIM (Master 141a; Judge 175a; Tr. 1185-1200)

Disallowance of this item is utterly groundless. 3A Collier (14 ed.) §62.29, p.1583, footnote 58; In re Crowder, 301 F. Supp. 1102 (E.D. Ark. 1969); In re Mill City Plastics, Inc., 129 F. Supp. 86,91 (D.Minn. 1955).

ITEM X - CLAIM OF INTERNAL REVENUE SERVICE (Master 142a; Judge 175a; Tr. 1200-1214)

This claim against Talcott was made and could have been made only because of its advances under the financing agreements. The services brought about withdrawal of the claim. The master allowed as falling within the clause; defense of a proceeding against Talcott concerning a "matter growing out of or connected with this agreement." No reason is given by the court why it is not so and applying the §243 aid-to-administration standard is an error of law.

ITEM XI - TRUSTEE'S ACTION TO RECOVER AN ALLEGED PREFERENCE (Master 142a; Judge 175a-176a)

The court disallows this item in disregard of the pertinent facts. Talcott made advances on the security of assigned accounts receivable which proved to be spurious. For repayment of the advances Talcott resorted to its other security in reliance

on cross-collateral or general lien provisions in its financing agreements. Such repayment is not a preference. Mathews v. James Talcott, Inc., 345 F. 2d 374, 379 (7 Cir. 1965) cert. den.382 U.S. 837. The action challenged Talcott's right to resort to the other security pursuant to its agreements. Such an action is concerning "a matter growing out of or connected with this agreement," - a clearest instance of compensability under the clause.

ITEM XII - PROCEEDING BY AMERICAN CATALOGUE COMPANY (Master 142a; Judge 176a-177a; Tr. 1228-1238)

The master's finding of 70 hours for Hahn and 50 hours for Abeson may not be modified without a showing of clear error. The court reduces the hours by half not on the basis of record evidence, merely on the basis of experience and familiarity. Such substitution of the judge's judgment for the master's is impermissible in law.

ITEM XIII - SERVICES RE JAMES TALCOTT, INC. v. VENDING UNLIMITED, INC. (Master 143a; Judge 177a; Tr.1018-1019)

The master found and allowed 35 hours for Hahn and 96 hours for Ryan. The court reduced Hahn's time to 10 hours not because the evidence does not support 35 hours, rather because it is a case of "two senior partners performing the same work in tandem." Hahn was in overall charge of the entire proceeding and

familiar with the facts and subject matter of the action handled by Ryan. Hahn supervised all the work. Without the benefit of Hahn's knowledge and supervision, Ryan would have had to spend more time and possibly with less success. There is no evidence supporting the court's assertion that the work of the two was "the same," in the sense that the conferences were unnecessary. Modification is erroneous in fact and in law.

ITEM XIV - SATISFACTION OF SUPERIOR LIENS ON THREE ROUTES (Master 143a; Judge 177a-178a; Tr. 1072-1091)

The court reduced from 50 to 25 hours of Hahn's time for these services as found by the master. Hahn estimated the time here as it was estimated for all other services. There appears to be no record basis for the court's finding, superseding that of the master, that the estimate of 50 hours included the services of Talcott's employees. (178a) The master's finding is not clearly erroneous.

ITEM XV - PROCEEDING BY AUTOMATIC CANTEEN COMPANY OF AMERICA (Master 143a; Judge 178a-179a; Tr.1214-1228)

The master found and allowed 40 hours for Hahn and 250 hours for Abeson. The court reduced the time for each in half, on the belief the time claimed and allowed was exaggerated, once again noting that there were no time records. Under the

clearly - erroneous test the modification is erroneous.

ITEM XVI - EXAMINATION OF TALCOTT'S OFFICERS IN TRUSTEE'S MASS ACTION (Master 143a; Judge 179a-180a; Tr.1014-1041)

These services were disallowed by the court on the ground that they relate to the agreement only indirectly. The examinations were designed to elicit facts for possible action against Talcott. The provision for reimbursement does not limit compensability to services in proceedings for recovery of money or property. It requires only that the services "concern" a"matter growing out of or connected with this agreement and/or the receivables assigned or" an "obligation of the debtors" to Talcott. The subject matter of the examination was that involved in the preference action later brought against Talcott (Item XI). The services are as compensable as is those in connection with that action.

ITEM XVII - ACTION BY AND AGAINST GENERAL ELECTRIC CORPORATION (Master 144a; Judge 180a; Tr. 1421-1422)

The master allowed the 70 hours for Hahn. The court reduced the time to 10 hours because the 70 hours claimed was only "a general assertion of time spent." True Hahn did not have papers or files because his work comprised conferences in connection with Ryan's work, with the Franklin Bank and Talcott.

he record does furnish a basis for an informed and reliable estimate and the reduction is unjustified.

ITEM XVIII - TRUSTEE'S SALE OF REMAINING PHYSICAL ASSETS ETC. TO VENDO COMPANY (Master 144a; Judge 180a; Tr.1042-1063)

The sale included property subject to Talcott's lien. Notice of hearing on the sale was given to Talcott because of the lien: its property was being sold. The fact that Talcott was notified of other proceedings as well is immaterial, although such notification was given also because Talcott was a secured creditor with liens on other property. Also immaterial is the fact that all creditors were given notice of the sale. The trustee's representation by his own counsel is irrelevant because the fact that the security is sold by the trustee does not deprive the secured creditor reimbursement for his attorney's fees (Item IV) as the master found the trustee properly consulted Talcott and its attorneys were instrumental in obtaining a better offer from Vendo. The services are compensable.

ITEM XIX - REPAYMENT BY TRUSTEE OF TALCOTT'S $750,000 LOAN (Master 144a-145a; Judge 181a-182a; Tr. 1130-1135)

Services in connection with repayment of the loan are as compensable as services in connection with making the loan (Item V).

ITEM XX - MISCELLANEOUS SERVICES (Master 145a; Judge 182a-184a; Tr. 1394-1445)

In the exercise of sound discretion, the master, an experienced judicial officer and lawyer, took into consideration absence of documentation and reduced Hahn's claim of 335 hours to 175 hours. Discretion was not abused. Total disallowance by the court is unwarranted. The court's errors in respect of these services is common to disallowance of some of the other services; treating Talcott on a par with general creditors rather than as a secured creditor claiming attorney's fees pursuant to contract; failing to give due consideration to the scope, complexity and intricacy of the services and the transactions to which they related; denying the efficacy and legal function of the contracts for attorney's fees by repeated allusion to the fact that services were rendered to Talcott and the trustee had his own attorney; disregarding the normal operation of the lawyer-client relationship by excluding meetings, telephone conversations and the like, all closely related and necessary to the performance of the main services, from the scope of the contract for reimbursement of attorney's fees.

Following are the services related in Hahn's supplemental affidavit (proof of claim, Document 8, Exhibit C, 344-361)

ITEM I - DISTRIBUTION OF ROUTES PROCEEDS (Master 145a; Judge 185; Tr. 1752-1831)

These services are disallowed because "the work claimed was performed for Talcott's benefit and duplicated the trustee's work ". (185a) The services are squarely within the clause. They represent achievement of the ultimate purpose of security: obtaining payment of the debt. They did not duplicate the trustee's work. A proof of claim had to be filed tracing the collateral sold into the proceeds. There were disputes among the claimants and with the trustee, meetings, discussions, settlement and appearance at court hearing for approval of the settlement.

ITEM II - AUTOMATIC CANTEEN COMPANY'S CLAIM TO ATTORNEY'S FEES OUT OF PROCEEDS OF THE HAMMOND ROUTE (Master 145a; Judge 185a-186a; Tr. 1709-1733)

Automatic Canteen obtained an adjudication that the proceeds of the Hammond, Indiana route constituted a trust fund for its claim, subject to prior liens. Establishment of the trust fund benefited other creditors, Talcott among them. For this benefit Automatic Canteen, in a proceeding, claimed a right

to attorney's fee out of the fund. Talcott contested the right and, when it was established, Talcott contested the amount claimed. The claim was reduced and to the extent of the reduction Talcott benefited by pro tanto increase of the balance left distribution. The services are within the clause; they were rendered in defense of a proceeding against Talcott involving its security which is a "matter growing out of or connected with this agreement". Disallowance on the ground the services were for Talcott and benefited Talcott was error for applying the wrong standard.

ITEM III - OBJECTION TO CONFIRMATION OF TRUSTEE'S PLAN
(Master 146a; Judge 186a-187a; Tr. 1267-1339)

The master allowed the claim. The court disallowed it, holding, "Attorney's fees incurred in opposing a plan of reorganization are not compensable under §243 unless the opposition is successful." There was no opposition to any part of the plan except to the part which excluded Talcott from consolidation. Exclusion denied Talcott, pursuant to the cross-collateral or general lien provision in the financing agreements, the right to apply Apco surplus to Continental deficiency. Talcott's objection to that part of the plan may be regarded a proceeding by it or a defense of the trustee's proceeding. Either way by the objection

Talcott sought to obtain payment out of security pursuant to the agreements. The opposition was not groundless and it was prosecuted in good faith, witness Judge Anderson's dissent, 517 F. 2d 997, 1002 (2 Cir. 1975). In these circumstances lack of success does not disentitle Talcott to all reimbursement. Some reimbursement is properly in order. Petition for certiorari was denied since the decision of November 18, 1975; assessment of value of the services can now be made.

ITEM IV - APPLICATION FOR PAYMENT OF CONSERVATOR'S AND TRUSTEES' CERTIFICATES (Master 147a; Judge 187a; Tr. 1339-1380)

The court denied allowance for these services under §243 because they did not benefit the debtors' estates. This standard is not controlling. The services are compensable under the agreements. Services in connection with loans in this case are compensable, hence services to enforce their payment are enforceable. The $650,000 loan under the August 14, 1963 agreement to Apco. The certificates for this loan guaranteed payment. The claim on certificates was practically admitted by the trustee. It was on the trustee's counter-motion for an accounting and all the accounting proceedings that involved the legal services in question, particularly the litigation over the Silco reserve which finally, by Judge Judd's decision on January 28, 1976 (95a-121a), established Talcott's right to apply $260,000 out of its security to payment of Continental's debts.

Sale of the Santa Ana, San Francisco and Buffalo routes pursuant to the August 14, 1963 agreement (Item IV, p. 23) and satisfaction of liens thereon from the proceeds, including Talcott's (Item XIV, p. 27) resulted in a $260,496 balance referred to as the Silco reserve. On Talcott's motion for payment of certificates and trustee's counter-motion for an accounting, an order was entered on February 13, 1973 (p. 8) directing an accounting and holding, among other things, that the Silco reserve must be applied to payment of certificates and it may not be applied to payment of Continental's debts, as Talcott contended.

On appeal from that order this court held the August 14, 1963 agreement ambiguous for resolution of the Silco reserve issue and it remanded for further proceedings to determine the parties' intent. (41a) By order of September 4, 1974, the court recused itself on the Silco reserve issue and assigned it to Judge Judd. The recusal was on the ground that the court "expressed an opinion concerning the intent of the agreement". (41a) Judge Mishler appeared before Judge Judd and testified as a witness for the trustee.

## POINT III

## THE JUDGE'S DISQUALIFICATION FOR HAVING BEEN A WITNESS FOR THE TRUSTEE WAS MANDATORY PURSUANT TO 28 U.S.C. §455

Judge Mishler testified before Judge Judd on June 30, 1975. At that time he had before him the trustee's objections to the master's report and Talcott's motion to confirm it. (200a) He decided the motions on November 18, 1975. He should have disqualified himself.

28 U.S.C. §455 provides in pertinent part that a judge "shall disqualify himself in any case in which he * * * has been a material witness * * *." At stake is the integrity of the judicial process.

> " * * * the language of the statute is mandatory * * * prejudice is presumed whether actually present or not. We believe that the language employed by Congress compels the conclusion that Congress was concerned with avoiding the appearance of partiality as well as avoiding the fact. (citing cases)." United States v. Amerine, 411 F. 2d 1130, 1133 (emphasis the court's).
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> * * * *
>
> As the statute now stands the duty to disqualify is placed solely upon the District Judge. * * * the statutory mandate must be observed." Id. at 1134.

The statute disqualifies a judge who has been of counsel as well as a witness. In Amerine the judge was disqualified

because he had been United States Attorney, hence counsel for the government. Judge Mishler distinguishes Amerine on that ground. (204a) There is no distinction; the statute mandates disqualification for having been a witness exactly the same as for having been counsel, the evil aimed at is the same.

Nor can disqualification be avoided by the judge's argument (205a) that the issue on which he testified is unrelated to the issue of Talcott's entitlement of fees. §455 does not condition disqualification on such identity of issues. Being a witness for one of the parties before him is the sole criterion. Moreover, the subject of his testimony, the Silco reserve, is directly related to the fee issue before him, for Talcott seeks fee reimbursement for services, inter alia, in connection with the Silco reserve and its creation: the August 14, 1963 agreement, the sale of the routes, the Silco and Dana offers, the Silco loan and related services. The §455 presumption of prejudice against Talcott and partiality for the trustee infects determination of Talcott's entire application, the parts that do not relate to Silco just as much as those that do.

The cases cited below do not support refusal to disqualify. Fortner and Perrin, Inc. v. Smith, 327 F. 2d 801, 808-809 (9 Cir. 1964) is not in any way applicable because the

referee was not a witness, he merely expressed an opinion and there was no objection under any disqualification statute. In those circumstances the comment there that disqualification is the better practice tends to support Talcott's position. Similarly inapplicable are Panico v. United States, 412 F. 2d 1151 (2 Cir. 1969) cert. denied, 397 U.S. 921 (1970) and United States v. Re, 372 F. 2d 641, 645 (2 Cir. 1967) because in each the judge was not a witness.

In the last cited case the court reserved the question of possible limitation of the scope of §455 by 28 U.S.C. §2255. The analogy between §2255 and the Bankruptcy Act (204a-205a) is not valid. §2255 mandates post-sentence motions to be made to "the court which imposed the sentence." The Bankruptcy Act places Chapter X reorganization in the charge of a judge with no mandate against reference or assignments of specific issues to magistrates or other judges. In the instant case there was both a reference and an assignment. The Chapter X judge's asserted familiarity with the proceedings is not as compelling or all-embracing as that of a sentencing judge. All judges are experts on fees and where fees are the subject of evidentiary hearing, especially before a master as here, the judge's right to supplement the record is minimal if not non-existent. Preservation of integrity of the judicial process by unexceptional enforcement of §455

outweighs any possible advantage of the bankruptcy judge's familiarity with the proceedings.

Before appearing as a witness Judge Mishler addressed an unsolicited letter to counsel. (45a-50a) Although Judge Judd thought it was written in the "hope that it would take the place of testimony" (67a), trustee's counsel confessed he didn't know "why the letter was written in the first place." (67a) And he avowed that "Judge Mishler has not appeared to be at all reluctant to give testimony". (54a)

The letter related the circumstances and substance of a conference in chambers on August 14, 1963 with the trustees and Talcott's counsel. (47a-49a) The conference dealt with Continental's urgent need of funds, some of the proposed terms of sale of the routes subject to Talcott's liens and a loan by Talcott. The conference was informational. It was followed by the key agreement of August 14, 1963. Judge Mishler did not conduct "negotiations". (205a) The letter also dealt with the judge's misimpressions regarding Talcott's claim to the Silco reserve by virtue of a general lien. (45a-47a) Finally the judge suggested a defense to the trustee that the sale of the routes included good will (46a) and he indicated how it may be proved. (49a-50a) Judge Judd correctly stated, "That's the

first time the suggestion of good will has come into the case." (50a)

On his cross-examination the judge elaborated on the good will defense and on how it might defeat Talcott's claim in whole or in part. (79a) Another new defense to the trustee suggested by the testimony had to do with the authorship of the key agreement of August 14, 1963 which this court found ambiguous. If Talcott's counsel drew it, the ambiguity would be resolved against Talcott. The judge didn't see him draw it and he didn't know who drew it; he "felt" Talcott's counsel drew it, he "felt it was his authorship and his form." (83a-84a)

The testimony about the trustees' broad general release to Talcott suggested still another defense to the trustee. Although objection to a question of interpretation of the release was sustained, the judge volunteered, "I didn't realize that this too may support the trustee's position here * * *." (76a)

Judge Mishler testified that he disqualified himself on the Silco issue because "I had a definite opinion as to the position of Talcott in this case. I thought it was hopeless". He formed this opinion "over the years". Asked why then he didn't disqualify himself when Talcott made the initial application, he did not

answer. Instead, he repeated the reason for his disqualification on the remand. (66a)

Talcott's "baseless" position rests on a lien provided for in its financing agreements. Judge Mansfield described it as a general lien. At the time of the March 21, 1974 hearing, Judge Mishler had read the opinion once. In connection with the June 25, 1975 letter, he looked for, couldn't find and "asked his law clerk to find the slip opinion. It hasn't been reported yet." (67a-68a) The opinion was claimed to be unclear and confusing. (68a-69a) In spite of Talcott's agreements, answer and briefs and the opinion, the claimed lien has "not yet been defined to me, to this very moment. I don't know what they mean." (68a-69a) And the judge wondered how filing requirements could be fulfilled for a general lien, suggesting perhaps an inquiry into another possible defense for the trustee. (82a, 89a)

The judge's testimony must be read in the light of Talcott's June 1974 motion for multiple relief (12a) asking the court to act on the remand for further proceedings and inter alia to proceed to a determination of the Silco reserve issue. Complaining of the delay since this court's decision in January 1974, the supporting affidavit (14a) recalled the reasons for the delay which came and at the March 21, 1974 hearing held pursuant to Talcott's request.

Judge Mishler explained he encountered difficulties in locating documents in court files. "We have no way of finding them * * *. I can't send any one down to look for it. I have to go down myself, and when I look at it, I stand there and turn around and go back. I may have to rely on hearings, on documents, on agreements, and I don't know where to find them." (17a)

The large tax claim was also stated to be a cause of delay. (17a-18a) The judge thought the government had a lien. This was denied and he did not initiate any inquiry. Counsel pointed out that the tax claim was subordinate to Talcott's liens which had to be determined without regard to it. The judge then conceded that in relation to Talcott's claim, the government's claim "isn't important" but he "wouldn't know what testimony to take" at a hearing and the documents might suffice. (19a)

As for the Silco issue, the judge said he was confused by Judge Mansfield's opinion which he had read once when it came down and not since. (19a) The supporting affidavit stated there was nothing confusing about the opinion and it specified every one of the judge's grounds for denying Talcott's claim which the opinion overruled. (22a-23a) The judge attributed his confusion to a lack of definition of the issues which could be cleared up by an accounting and he thought Judge Mansfield was of the same

view. Judge Mansfield expressly mentioned an accounting that had been filed. Judge Mishler didn't know where it was filed, he had not seen it and he wasn't "going to go through 10 or 20 hundres of pages of figures". (20a-21a) The affidavit adverted to and urged insufficiency of other reasons and causes of delay. (21a, 23a)

It is reasonable to view the testimony as a reflection of the judge's hostile, through perhaps not always entirely apparent, reaction to Talcott's prodding motion critical of his handling of its claims. The presumption of prejudice and the appearance of partiality that being a witness per se creates gain substances and assume a semblence of reality by the testimony given.

Consistent with that view is the remarkable circumstance that every one of the trustee's large number of actions, controversies and proceedings have been terminated by compromise approved by Judge Mishler, the last in December 1974. Disputes with Talcott alone remain unresolved and additional litigation is foreshadowed. After argument of the last appeal, Judge Mansfield suggested the desirability of compromise. Almost immediately after the suggestion, trustee's counsel dismissed any possibility of compromise. The master's several invitations to discuss possible

compromise were similarly refused. At the pre-argument conference on this appeal, Mr. Fensterstock, Staff Counsel, urged settlement discussion. Trustee's counsel suggested Talcott make an offer. At that time there was pending a motion to dismiss the appeal. The suggestion of an offer under the gun of the motion, instead of a full scale joint assessment of the merits, appeared to be so obviously unfair that the matter was promptly dropped.

Counsel did approach for settlement discussion of the Silco matter pending before Judge Judd. At the time there were fair reasons to anticipate a favorable outcome for Talcott. A counter-proposal to consider settlement of all outstanding controversies instead of Silco alone was not accepted.

Judge Mishler has never attempted to explore compromise, explaining at a hearing that he would not do so in a non-jury matter, although the reorganization has been pending many years and the continued litigation is costly to the estate and to Talcott.

## CONCLUSION

The order of December 15, 1975, in so far as it denies Talcott's motion for an order striking the order of November 18, 1975 from the records of the district court and declaring itself disqualified to sit on consideration of the subject matter of that order, should be reversed with a remand directing that the subject matter of the order of November 18, 1975 be assigned to another judge. If the said part of the order of December 15, 1975 is affirmed then the order of November 18, 1975, in so far as it modifies the report of the Special Master dated April 28, 1975, in respect of reimbursement to appellant for attorney's fees, should be reversed.

Respectfully submitted,

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2 Copies Received

Date March 31, 1976

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By _____